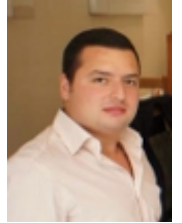


# As the global economic landscape undergoes significant transformation, Russia must reform its domestic and foreign policies to meet new challenges

**LSE** [blogs.lse.ac.uk/euoppblog/2013/08/20/as-the-global-economic-landscape-undergoes-significant-transformation-russia-must-reform-its-domestic-and-foreign-policies-to-meet-new-challenges/](http://blogs.lse.ac.uk/euoppblog/2013/08/20/as-the-global-economic-landscape-undergoes-significant-transformation-russia-must-reform-its-domestic-and-foreign-policies-to-meet-new-challenges/)

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*Russia's vast energy resources have long given the country substantial influence in the international arena. As [Hayk Hovhannisyan](#) notes, however, a number of current developments present a threat to Russia's economic and global position. New energy supply routes and the shale gas extraction 'boom' may reduce demand for Russian energy resources; while a slowdown in the BRIC economies, allied with negotiations over the Transatlantic Trade and Investment Partnership (TTIP) and the Trans-Pacific Partnership (TPP), could have profound implications for the country's economy.*



Three major factors are likely to shape the international agenda in the coming years: a slowdown in emerging economies; transformation of traditional energy markets and supply sources; and two free trade 'mega-agreements' between the US and its transoceanic trade partners. Russia's current political and economic orientation puts it in a disadvantageous position in the face of these developments. The adverse economic effects of the first two trends are direct and already visible, while the indirect isolating consequences of the later will be felt in the future.

Despite a sustained period of high oil prices, Russia has registered falling growth rates for six consecutive quarters, with 1.6 and 1.2 per cent growth in the first two quarters of 2013. It is unlikely that the country will reach the forecasted growth target of 2 per cent for this year. Down from its peak of 8.5 per cent in 2007, this is the largest drop in growth among the BRIC countries (Brazil, Russia, India and China) during the same period.

Looking at the broader perspective of the BRICs, some might hope that this deceleration is a cyclical phenomenon. Others, like professor [Nouriel Roubini](#) of NYU's Stern School of Business, believe that the main contributing factors – state capitalism, the end of the commodity super-cycle, and a hard landing in China – are structural. The slowdown in the BRICs might signal an end to the era of endless increases in demand for commodities. [Evidence](#) suggests that commodities may have already entered a period of sustained price decreases. If this is true, the world's most resource-abundant country will pay a heavy toll, as commodities account for up to two-thirds of Russia's exports. Almost 30 per cent of its GDP and half of Federal Budget revenues are generated through hydrocarbons.

European demand for Russian energy resources already fell by 8 per cent in 2012. Asia still shows remarkable absorbing capacities, but even there Moscow faces significant challenges. China, for example, is not only slowing down, but also diversifying its energy sources. It has estimated shale gas reserves of 1,275 trillion cubic feet, which is more than those of the US and Canada combined. The world's largest energy companies are actively tapping into this vast resource. China's National Energy Administration is planning to increase the output of its shale gas to 2.2 trillion cubic feet by 2020.

While GazProm has recently missed another deadline for finalising the terms of a large gas supply contract to China, the Chinese government is continuously building up its supplies from Central Asia and other areas. It is constructing the third line of the Turkmenistan-China gas pipeline, which will increase the throughput of gas from Kazakhstan, Uzbekistan and Turkmenistan to 2 trillion cubic feet per year by 2016. In July, the Myanmar-China pipeline, supplying gas from the deepwater Shwe project in the Bay of Bengal, also became operational.

Similar shifts are also noticeable on Russia's western frontiers. The EU possesses 75 per cent of the shale gas reserves of the US, and is advancing their exploitation, albeit at a much slower pace. While political debates impede a full-blown 'shale' revolution inside the EU, across the border, in Ukraine, the Dutch energy giant Shell is already putting efforts into its 0.7 trillion-cubic-feet-per-year shale gas field. To the south, the upcoming Trans-Adriatic pipeline and the newly discovered huge gas reserves of the Eastern Mediterranean will further diversify Europe's energy supply options. In the beginning of August, during his visit to Washington, the Greek Prime Minister, Antonis Samaras, announced that Israel, Cyprus and Greece will be capable of fully satisfying Europe's demand for natural gas through their Mediterranean reserves.

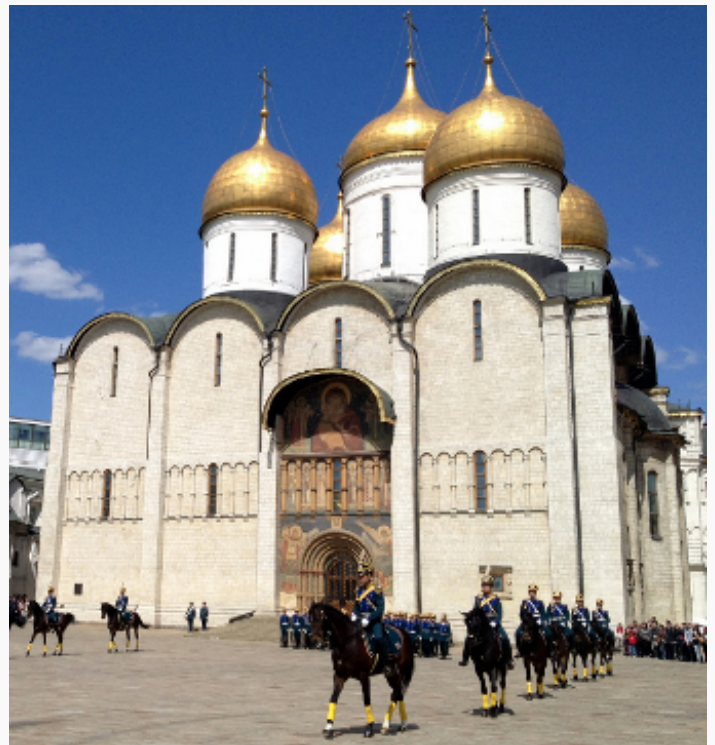
In his meeting with President Obama, Samaras also promised something else. In the first half of 2014, during its Presidency of the Council of the European Union, Greece will exert maximum effort to finalise the negotiations over the Transatlantic Trade and Investment Partnership (TTIP) between the EU and the US. These two parties account for almost half of global output, and the new free trade zone is intended to provide a new boost for their slowly recovering economies. It is expected that the national incomes of the two countries will increase by €86bn and €65bn, and bilateral exports by €186bn and €159bn, for the EU and the US respectively. While some have celebrated this partnership as an '[economic NATO](#)', [Karel De Gucht](#), the European Commissioner for Trade, has vowed that the two largest economies of the world will not withdraw from the rest of the world.

NATO or not, this is an important development from which Russia is unlikely to benefit. One of the core ideas of the agreement is to synchronise and remove regulatory barriers between the US and the EU. This can bring significant benefits not only for domestic companies in the two economies, but also up to €100bn in gains to those in other countries. One mechanism is that uniform manufacturing standards can create huge savings for firms in non-TTIP countries exporting to both European and American markets (i.e. Kia and Toyota are supposed to benefit from a common standard on seatbelts as much as Ford and Renault). With its commodity-dominated exports, Russia's stake in these gains is uncertain.

Likewise, on the other side of the world, officials from twelve Pacific countries – Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US and Vietnam – are preparing for the 19th round of Trans-Pacific Partnership (TPP) negotiations that will take place in Bandar Seri Begawan at the end of August. These countries account for 40 per cent of world GDP, and it is estimated that TPP, the largest free trade agreement ever agreed, can boost their aggregate annual output by another \$300bn.

### **Russia and the changing global economic landscape**

It is clear that to retain its global influence, the Kremlin has to remodel Russia's role through economic diversification and more amicable foreign political discourse. No signs of the latter are visible at this moment. The level of misunderstandings between Moscow and Washington reached a point where, on August 7<sup>th</sup>, the US President had to cancel the upcoming summit with Russia's President Vladimir Putin. While foreign policy might be a matter of top-down resolve, which either exists or not, economic modernisation takes more than that.



Cathedral Square, Moscow Kremlin (Credit: Kwong Yee Cheng, CC-BY-SA-3.0)

Innovation became a buzzword in former President Medvedev's administration when he launched the state-guided Skolkovo project in 2009, a Silicon Valley to-be based near Moscow. But creativity and entrepreneurship are usually freedom-loving species. Four years and almost three billion government-invested dollars later, the [project](#) resembles a huge construction site in a dubious condition. There are few private investors, the market of venture financing is rudimentary, not to mention the red tape and corruption allegations.

Olga Uskova, the president of Cognitive Technologies, a major Russian software developer, predicts that by 2014 Skolkovo will become an accomplished construction project, but without innovations. On a wider scale, the unfavourable investment climate has caused a massive capital flight of \$360bn in the last five years, or around 4 per cent of GDP annually. Recently, the Russian Ministry of Economy has revised its capital outflow estimates for 2013 from zero to \$30bn.

Although Russia's decade of hydrocarbon-fuelled rapid growth might be over, its energy and currency reserves are vast, and money in Moscow will not run out quickly. But nevertheless, the Kremlin's capacity for political and economic pressure on the energy-dependent countries, stretching from East Asia, to the [South Caucasus](#), to Western Europe and beyond, will gradually decline. Staying on the sidelines of the two massive American-led free trade zones will not help.

Possessing a huge territory, abundant natural resources, a highly educated population, and an extremely rich cultural heritage, Russia is performing far below its potential. In Fyodor Tyutchev's famous words, "you cannot grasp Russia with your mind... you can only believe in it". One wonders whether the great 19<sup>th</sup> century poet would have the same view, had he lived in our time. Hopefully Russia's enlightened, well-travelled and well-informed new generation will revive their belief in the country, at the same time making it more understandable for themselves and the rest of the world.

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*Note: This article gives the views of the author, and not the position of EUROPPE – European Politics and Policy, nor of the London School of Economics.*

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